The Commonwealth of Massachusetts

DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY

November 18, 2004

D.T.E. 04-74

Petition of Nantucket Electric Company and Massachusetts Electric Company for approval by the Department of Telecommunications and Energy, pursuant to G.L. c. 164, §§ 14, 15, 15A, 16 and 17A for: (1) Nantucket Electric Company to execute one or more loan agreements, supplemental loan agreements and/or notes in an aggregate amount not to exceed $65 million; (2) Massachusetts Electric Company to guarantee Nantucket Electric Company's obligation to pay and to issue additional first mortgage bonds; and (3) related exemptions.

APPEARANCE: Paige Graening, Counsel
James Meehan, Counsel
25 Research Drive
Westborough, MA 01582-0099
FOR: NANTUCKET ELECTRIC COMPANY and
MASSACHUSETTS ELECTRIC COMPANY
<u>Petitioners</u>

TABLE OF CONTENTS

I. INTRODUCTION

On July 26, 2004, Nantucket Electric Company ("Nantucket") and Massachusetts Electric Company ("MECo") (collectively, "Companies"), filed with the Department of Telecommunications and Energy ("Department"), pursuant to G.L. c. 164, § 14, a petition for authorization and approval for: (1) Nantucket to execute one or more loan agreements, supplemental loan agreements, and/or notes with the Massachusetts Development Finance Authority ("MDFA") or with direct or indirect parents of Nantucket, in connection with the issuance of new taxable and/or tax-exempt debt in an amount not to exceed $65 million, together with related financing and security agreements; and (2) MECo to issue additional first mortgage bonds to be pledged as credit support for the indebtedness of Nantucket. The Companies also seek an exemption from the competitive bidding requirements of G.L. c. 164, § 15 and the par value requirements of G.L. c. 164, § 15A. In addition, MECo seeks authorization, pursuant to G.L. c. 164, § 17A, to guarantee Nantucket's obligation to pay principal, premium, if any, and interest on Nantucket's debt.

Pursuant to notice duly issued, public and evidentiary hearings were held at the Department's offices in Boston on September 22, 2004. No petitions for leave to intervene were filed. At the hearing, the Companies presented the testimony of two witnesses in support of their petition: Robert G. Seega, assistant treasurer of MECo and assistant treasurer and director of treasury services for National Grid USA Service Company, Inc., and David Fredericks, vice president of Nantucket. The evidentiary record consists of 31 exhibits and eleven responses to Department record requests.

II. DESCRIPTION OF THE PROPOSED FINANCING

A. Issuance of Long-Term Debt

1. Nantucket

Nantucket seeks authorization to issue new taxable or tax-exempt debt or refinance outstanding taxable or tax-exempt bonds, in an amount not to exceed $65 million in the aggregate, together with related financing and security agreements (Exh. NEC/MEC-1 (Rev.) at 3). Nantucket proposes that this debt would be issued either in connection with the issuance by the MDFA of taxable or tax-exempt bonds ("New MDFA Bonds"), or in the form of long-term promissory notes with direct or indirect parents of Nantucket ("National Grid Notes") (collectively, "New Debt") (id.). Nantucket intends to use the proceeds of the proposed issuance of New Debt as follows: (1) $35 to $40 million to finance a proposed second underground and undersea cable to Nantucket Island ("Second Nantucket Cable"); (2) $13.3 million to $14.7 million to refinance existing MDFA debt associated with the existing underground and undersea cable to Nantucket Island ("1996 Series Bonds");[1] (3) $2.8 million to refinance existing MDFA debt originally issued in 1991 ("8.5 Percent Series Bonds");[2] and (4) $7.5 million to finance other anticipated capital expenditures over the

---

1 The 1996 Series Bonds were originally issued in 1996 under the MDFA's previous name, the Massachusetts Industrial Finance Authority, and carry various interest rates ranging from of 4.10 percent to 6.75 percent (Exh. NEC/MEC-1 (Rev.) at 9). These bonds became callable on July 1, 2001 at a price equal to 102 percent of par and will be callable on July 1, 2006 at a price equal to 101 percent of par (id.).

2 The 8.5 Percent Series Bonds were originally issued in 1991 under the MDFA's previous name, the Massachusetts Industrial Finance Authority, and carry an interest

(continued...)

next four years (Exh. DTE 1-5). The Companies indicate that, in the event that the Second Nantucket Cable is not approved for construction, Nantucket will limit the aggregate principal of New Debt to an amount not exceeding $25 million outstanding at any one time (Revised Application at 4).

Nantucket requests the authority to issue the New Debt from time to time through December 31, 2007 as the need for funds arises (Exh. NEC/MEC-1 (Rev.) at 11; Tr. at 14). Because the tax-exempt MDFA New Bonds will constitute private activity bonds under section 142(a)(8) of the Internal Revenue Code of 1986 ("IRC"), the MDFA is only permitted to issue the New MDFA Bonds to the extent an allocation ("volume cap") is made in accordance with the requirements of the IRC (Exh. DTE 1-2; see 26 U.S.C. § 146 (2004)).[3] The MDFA has advised Nantucket that it intends to allocate $10 million of the Commonwealth of Massachusetts' 2004 total volume cap of $514 million to the Second Nantucket Cable project (Exh. DTE 1-2). To the extend that Nantucket's capital needs are greater than the level of tax-exempt debt allowed to Nantucket by the MDFA in any particular year, Nantucket may issue some taxable debt incurred either through the MDFA or in the form of National Grid Notes (Exhs. NEC/MEC-1 (Rev.) at 11; DTE-2; Tr. at 26). However, the Companies state that Nantucket intends to obtain as much volume cap as possible from the MDFA and, to the

---

2 (…continued)
rate of 8.5 percent, and became callable as of March 1, 2004 (Exh. NEC/MEC-1 (Rev.) at 9).

3 Volume caps only apply to new tax-exempt issuances; tax-exempt bonds issued to refinance existing tax-exempt issues do not require an allocation of volume cap (Exh. NEC/MEC-1 (Rev.) at 4; Tr. at 78-79).

extent that additional volume cap is made available, Nantucket will use the additional volume cap to reduce the amount of taxable debt that may be issued (Exhs. NEC/MEC-1 (Rev.) at 4; DTE 1-2).

The New MDFA Bonds will have a maximum term of 40 years and will be structured as multi-modal bonds providing various interest rate options (Exh. NEC/MEC-1 (Rev.) at 5, 16). The New MDFA Bonds will provide for the option of either a fixed rate mode or a variable rate mode with daily, weekly, monthly, auction, commercial paper, term or semi-annual rates (id. at 5). The various modes establish different time periods during which a particular interest rate would remain in effect (id.). The New MDFA Bonds will be structured so as to permit Nantucket, with the consent of MDFA, to convert the bonds between interest rate modes (id. at 3-4). The actual rate for each period, other than those related to the auction mode, will be set by Nantucket's remarketing agent, Lehman Brothers, based upon then prevailing market conditions (id. at 5; Tr. 86-87). If the auction mode is selected, the interest rate on the New MDFA Bonds will be established through the auction procedures set forth in the applicable loan and trust agreement (Exh. NEC/MEC-1 (Rev.) at 5). The initial interest rate will be established by MDFA, Nantucket, and underwriters prior to the issuance of the New MDFA Bonds (id.). Nantucket will determine the timing and amounts of the New MDFA Bonds to be actually issued based on current market conditions (id. at 13).

The National Grid Notes would be incurred through borrowings from direct or indirect parents of Nantucket, in the form of promissory notes specifying the amount, maturity, interest rate, and other relevant provisions (id. at 6). The National Grid Notes would have a maturity greater than one year, may be secured or unsecured, and use either a fixed or variable interest rate based on the lowest of: (1) National Grid Transco plc's cost of funds; (2) the cost of funds incurred by a National Grid USA associate company; or (3) the cost of funds available to Nantucket at the time of the borrowing from a non-associated third party (id.; Tr. at 106-111).

The Companies propose a maximum interest rate for tax-exempt New MDFA Bonds equal to the then-current rate for U.S. Treasury securities of similar maturity at time of closing, plus 150 basis points (Exh. NEC/MEC-1 (Rev.) at 12). Notwithstanding this maximum interest rate, the Companies request that if the New MDFA Bonds are issued as taxable securities, or are no longer considered tax-exempt securities, or if borrowings are incurred in the form of National Grid Notes, the maximum interest rate be set equal to the then-current rate for U.S. Treasury securities of similar maturity at the time of closing, plus 300 basis points (id.).[4] According to the Companies, these interest rate limits will provide Nantucket with flexibility to refinance the New MDFA Bonds during their term in the event that market conditions should change (id.; Tr. at 93-96).

While the timing of the refinancing of the 8.5 Percent Series Bonds and 1996 Series Bonds will depend upon the allocation of volume cap by MDFA, the Companies estimate that (1) refinancing the 8.5 Percent Series Bonds will provide a net present value savings of

---

4 The New MDFA Bonds will become taxable instruments if Nantucket fails to adhere to the associated bond covenants, including the use of the facilities financed with the bonds, expenditure and investment of bond proceeds, and other customary requirements (Exh. DTE 1-8).

approximately $331,021 on an after-tax basis, and (2) refinancing the 1996 Series Bonds will provide a total net present value savings of between $208,536 and $244,002 on an after-tax basis (Exh. NEC/MEC-1 (Rev.) at 11, exhs. RGS-1(A); NEC/MEC-1, exh. RGS-1(B)).[5] Thus, the Companies estimate a total net present value savings of between $539,557 and $575,023 on an after-tax basis (id.).[6]

2. MECo Pledged Bonds

In order to provide additional security for Nantucket's New MDFA Bonds, the Companies request that the Department authorize the issuance by MECo of one or more series of first mortgage bonds ("Pledged Bonds") not exceeding $65,000,000 as security for the New MDFA Bonds (Exh. NEC/MEC-1 (Rev.) at 15; Tr. at 34-35). The Pledged Bonds may be pledged to the trustee for the New MDFA Bonds or to an insurer in connection with obtaining bond insurance for the New MDFA Bonds (Exh. NEC/MEC-1 (Rev.) at 15). In the event of a default on the loan and trust agreement for the New MDFA Bonds, interest and principal due

---

5 If Nantucket refinances the 1996 Series bonds before July 2007, the principal amount to be refinanced would be $14.7 million. If, however, Nantucket determines that it is more advantageous to refinance these bonds after July of 2007, but prior to June 30, 2008, then the principal amount to be refinanced will decrease to $13.3 million because the 1996 Series Bonds had been structured such that $1.4 million in bonds matures annually through July 1, 2017 (Exhs. NEC/MEC-1, exh. RGS-1(B); DTE 1-21, at 19; Tr. at 14).

6 The Company relied on a six percent discount rate for its net present value analysis of savings. In selecting this discount rate, the Company explained that it used a "matched fund" rate -- an estimate of what the existing bonds could be refunded at for their remaining lives (Exhs. NEC/MEC-1, exhs. RGS-1(A); RGS-1(B); DTE 1-12).

on the Pledged Bonds will be paid to the trustee for the New MDFA Bonds or to the bond insurer, as appropriate (id. at 17).

The Pledged Bonds would be issued in one or more series, but no Pledged Bonds will mature more than 40 years from the date of issuance (id. at 16). The interest rate and maturity of the Pledged Bonds would parallel the provisions of the New MDFA Bonds (id. at 17). Moreover, the Pledged Bonds would be sold at a price not less than 95 percent nor more than 100 percent of their principal amount (id. at 16). The Companies states that the Pledged Bonds may or may not be callable, refundable, or puttable (id.). Interest on the Pledged Bonds would not be required to be paid so long as interest payments are made on the New MDFA Bonds (id. at 17). According to the Companies, because MECo will receive no proceeds from the Pledged Bonds, the issuance of these bonds will not affect its capitalization (id. at 16).

B. Exemption from Competitive Bidding Requirements of G.L. c. 164, § 15

The Companies seek an exemption from the competitive bidding and publication requirements of G.L. c. 164, § 15 pertaining to the issuance of debt securities (id. at 21). The Companies state that, depending on the type of security and market conditions at the time of issuance, the New Debt will be sold: (1) by competitive bidding; (2) by negotiations with underwriters; (3) by negotiations directly with investors; (4) through one or more agents; or (5) to one or more agents as principal for resale to investors (id. at 10). The Companies contend that, if market conditions warrant the use of negotiated offerings, an exemption from competitive bidding requirements will facilitate their ability to respond more quickly to market changes, which the Companies represent is essential to the facilitation and effectiveness of negotiated offerings (id. at 21). Additionally, because the terms of the Pledged Bonds would generally correspond to the terms of the related New Debt, the Companies request an exemption from the competitive bidding and publication requirements of G.L. c. 164, § 15 with respect to the Pledged Bonds (id.).

C. Exemption from Par Value Requirements of G.L. c. 164, § 15A

Nantucket and MECo request an exemption from the par value requirements of G.L. c. 164, § 15A (Exh. NEC/MEC-1 (Rev.) at 21; Tr. at 3). The Companies state that underwriters may desire to receive their compensation in the form of a discount from face value of the bonds (Exh. NEC/MEC-1 (Rev.) at 21). The Companies state that the ability to issue debt at a price not less than 95 percent nor more than 100 percent of its principal amount may enhance the marketability of the debt through greater investor interest and, therefore, favorably affect the cost of borrowing (id.; Exh. DTE 1-4). Also, the Companies explain that because the terms and conditions of MECo's Pledged Bonds must track the terms and conditions of the New MDFA Bonds; to the extent that the New MDFA Bonds provide for a discount, the Pledged Bonds would also require an identical discount provision (Exh. NEC/MEC-1 (Rev.) at 21).

D. Guarantee of Nantucket's Indebtedness

The Companies request authorization for MECo to guarantee the indebtedness of Nantucket's obligation to pay the principal, premium if any, and interest, associated with the New MDFA Bonds (id. at 3). According to the Companies, a direct MECo guarantee of

Nantucket's debt would simplify the marketing of the New MDFA Bonds to potential investors, without imposing any significant additional risk on MECo (id. at 14).

III. CAPITAL STRUCTURE

A. Nantucket

Nantucket states that its capitalizable utility plant in service as of June 30, 2004, was $50,035,000 (RR-DTE-7). The accumulated depreciation against this plant is $18,326,000 (id.). Thus, as of June 30, 2004, Nantucket had a net utility plant in service of $31,709,000 (id.).

As of June 30, 2004, Nantucket reported a total capitalization of $45,688,001, consisting of $21,592,000 in long-term debt and $24,096,001 in total common equity (Exh. DTE 1-15; RR-DTE-7). The Company's common equity balance consisted of $1 in common stock, $22,481,000 in other paid-in capital, $2,777,000 in retained earnings, a negative $1,000 in net unrealized loss on securities, and a negative $1,161,000 related to additional minimum pension liability (id.). Excluding $15,679,000 in acquisition premiums booked to paid-in capital, as well as the accumulated comprehensive losses on securities and pension liabilities from capitalization, Nantucket's capital structure as of March 31, 2004 consisted of 76.04 percent long-term debt and 23.96 percent common equity (id.).

B. MECo

MECo states that its capitalizable utility plant in service as of March 31, 2004, was $2,342,310,000 (Exh. NEC/MEC-1, exh. RGS-4(B) at 3). The accumulated depreciation against this plant is $781,484,000 (id.). Thus, as of March 31, 2004, MECo had a net utility plant in service of $1,560,826,000 (id.).

As of March 31, 2004, MECo reported a total capitalization of $2,029,609,000, consisting of $252,209,000 in long-term debt, $4,727,000 in preferred stock, and $1,772,673,000 in total common equity (id.). The Company's common equity balance consisted of $59,953,000 in common stock, $1,508,991,000 in other paid-in capital, and $203,729,000 in retained earnings (id.). Excluding $1,023,272,000 in acquisition premiums booked to paid-in capital from capitalization,[7] MECo's capital structure as of March 31, 2004 consisted of 25.06 percent long-term debt, 0.47 percent preferred stock, and 74.47 percent common equity (id.).

IV. STANDARD OF REVIEW

A. Long-Term Debt Issuance

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness[8] by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985)

---

7 See Massachusetts Electric Company, D.T.E. 04-51, at 6 (2004).

8 Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the company has met the net plant test.[9] Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 842, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946) ("Lowell Gas"). In cases where no issue has been raised about the reasonableness of management decisions regarding the requested financing, the Department limits its G.L. c. 164, § 14 review to a determination of reasonableness of the company's proposed use of the proceeds of a stock issuance. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed

[9] The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds, or other securities by a gas or electric company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories, or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence showing that its net utility plant (utility plant less accumulated depreciation) is equal to or in excess of its total capitalization. Berkshire Gas Company, D.T.E. 03-89, at 15-16 (2004); D.P.U. 84-96, at 5. The Department's definition of total capitalization is the sum of long-term debt, preferred stock, and common stock outstanding.[10] D.T.E. 03-89, at 15-16; D.P.U. 84-96, at 5. Where issues concerning the prudence of the company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

B. Exemption from G.L. c. 164, §§ 15 & 15A

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of $1,000,000 in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds

---

10 For purposes of the net plant test, the premium on common stock is treated as common stock. D.T.E. 03-89, at 23.

that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Berkshire Gas Company, D.P.U. 89-12, at 11 (1989); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See, e.g., D.P.U. 88-32, at 5. However, G.L. c. 164, § 15 requires advertising as the general rule, and waiver cannot be automatic, but must be justified whenever requested. Bay State Gas Company, D.T.E. 02-73, at 14.

Pursuant to G.L. c. 164, § 15A, a company is required to sell long-term bonds, debentures, notes, or other evidence of indebtedness at no less than the par value or face amount unless sale at less than par value is found by the Department to be in the public interest. See, e.g., Boston Edison Company, D.P.U. 91-47, at 13 (1991). The Department has found that it is in the public interest to grant an exemption from the par value requirement where market conditions make it difficult at times for a company to price a particular issue at par value and simultaneously offer an acceptable coupon rate to prospective buyers. Bay State Gas Company, D.P.U. 91-25, at 9 (1991). The Department also has found that it is in the public interest to authorize the issuance of debt securities below par value where this technique offers a company enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates, particularly if this benefits the company's ratepayers in the form of lower interest rates and a lower cost of capital. Id.; see also Boston Gas Company, D.P.U. 92-127, at 8 (1992); D.P.U. 91-47, at 12-13. If the Department authorizes a company to issue debt securities at less than par value, the Department may establish the method by which the company is required to amortize any discount.[11] G.L. c. 164, § 15A; see, e.g., D.P.U. 92-127, at 8; D.P.U. 91-47, at 15.

C. Guarantee of Indebtedness Under G.L. c. 164, § 17A

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to "loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of any corporation, association, or trust." The Department has required that such proposals must be "consistent with the public interest" that is, a § 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial. Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Gas Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each § 17A case on their own merits to make a determination that the proposal is consistent with the public interest. D.P.U. 91-165, at 7. The Department will base its determination on the totality of what can be achieved by, rather than on a determination of any single gain that could be derived from, the proposed transaction. D.P.U. 850, at 7. The Department has also stated that "if a particular proposal has negative aspects, we will find that such a proposal is consistent with the

---

[11] The discount is the difference between the par value of a bond, note, or other debt security and the actual issue price when the actual issue price is less than par value.

public interest if, upon consideration of all its significant aspects viewed as a whole, the public interest is at least as well served by approval of the proposal as by its denial." Id. The Department has found that the public interest standard best accommodates the Department's interest in protecting the utility's ratepayers from the adverse effects of unwarranted § 17A transactions and a utility's interest in having flexibility in a changing marketplace to meet long term objectives of its ratepayers and shareholders. D.P.U. 850, at 7; D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department's analysis must consider the overall anticipated effect on ratepayers of the potential costs and benefits of the proposal. Bay State Gas Company, D.T.E. 98-31, at 55; D.P.U. 91-165, at 8. The effect on ratepayers may include consideration of a number of factors, including but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transactions; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial integrity of the utility. Id. After consideration of such provisions, viewed as a whole in light of the described factors, the Department may then approve a § 17A investment.

V. ANALYSIS AND FINDINGS

A. Issuance of Long-Term Debt

1. "Reasonable Necessity" Standard

The Companies have stated that their proposal to execute one or more loan agreements or supplemental loan agreements with MDFA, as well as with direct or indirect parents of Nantucket, in an amount not to exceed $65 million is for the purposes of (1) financing the construction of the Second Nantucket Cable, (2) financing the construction of additions and improvements to Nantucket's plant, (3) issuing new tax-exempt debt to refinance outstanding tax-exempt bonds together with related financing and security agreements, and (4) issuing one or more additional series of Pledged Bonds (Exh. NEC/MEC-1 (Rev.) at 4). The Pledged Bonds will be issued by MECo to secure Nantucket's obligations for payment of the principal, interest and premium, if any, on the New MDFA Bonds (id. at 14-15).

The predominant purpose of the proposed debt issuance is to finance the construction of the Second Nantucket Cable, along with various other construction projects for Nantucket (Exhs. NEC/MEC-1, at 3; DTE 1-1; DTE 1-5; Tr. at 15-17; RR-DTE-1). The Department has found that the expansion or replacement of utility plant is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Dover Water Company, D.T.E. 04-50, at 8 (2004); Witches Brook Water Company, D.T.E. 03-81, at 8 (2003); Aquarion Water Company of Massachusetts, D.T.E. 02-57, at 7-8 (2002); Fitchburg Gas and Electric Light Company, D.T.E. 01-43, at 6 (2001); Blackstone Gas Company, D.T.E. 98-91, at 5 (1999); NEES/Nantucket Acquisition, D.P.U. 95-67, at 11 (1995).

In this case, Nantucket proposes to issue long-term debt prior to the completion of plant construction (Exh. NEC/MEC-1, at 3). Customarily, utility plant construction is initially financed with short-term debt or internally-generated funds and, once the plant is completed and placed into service, long-term debt is issued with the proceeds used to retire the outstanding short-term debt. D.T.E. 04-50, at 9; Fitchburg Gas and Electric Light Company, D.T.E. 03-72, at 7 (2003); Berkshire Gas Company, D.P.U. 94-14, at 4-5 (1994). However, on occasion, circumstances may arise that render the issuance of long-term debt prior to incurring construction costs more cost-effective than the use of short-term financing. Nantucket's short-term debt limit, as established by the Securities and Exchange Commission, is $6,000,000 (Exhs. NEC/MEC-1, exh. RGS-4(A)-1, at 17; DTE 1-21, at 123.10; Tr. at 23). While Nantucket's short-term debt limit appears sufficient to provide for routine construction and working capital needs, it is clearly insufficient to finance a capital project with an estimated cost of $42 million, of which approximately $3.9 million has been expended to date (Tr. at 16, 20; RR-DTE-2). In this case, exclusive reliance on short-term debt financing would be insufficient to provide for the costs of the Second Nantucket Cable. Moreover, Nantucket has demonstrated that the issuance of up to $12,800,000 in long-term debt through the MDFA by the end of 2004 is necessary to ensure that Nantucket will have access to MDFA financing for the duration of the Second Nantucket Cable project, as well as to allow Nantucket to refinance its outstanding $2,800,000 in 8.5 Percent MDFA bonds on an economic basis (Exhs. NEC/MEC-1 (Rev.) at 11; DTE 1-2; Tr. at 19-20). In consideration of these factors, the Department finds that the issuance of additional debt through the MDFA, or through direct and indirect parents of Nantucket, for the purposes the Companies have described, including those associated with the Second Nantucket Cable project, is reasonably necessary to accomplish a legitimate purpose in meeting Nantucket's service obligations in accordance with G.L. c. 164, § 14.[12]

Concerning Nantucket's proposed use of the proceeds from the New MDFA Bonds to refinance existing MDFA debt, the Department has found that issuing debt for the purposes of refinancing long-term debt is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Blackstone Gas Company, D.T.E. 03-65, at 4 (2003); Western Massachusetts Electric Company, D.T.E. 02-49, at 10 (2003); New England Power Company, D.P.U. 95-101, at 11 (1995). Likewise, the Department has found that redeeming existing securities and funding utility operations is a customary purpose of securities issuances. Southern Union Company, D.T.E. 03-3, at 18 (2003); Berkshire Gas Company, D.P.U. 96-64, at 8-9 (1996). Nantucket has demonstrated that the refinancing of existing MDFA debt will result in interest expense savings on a net present value basis ranging from approximately $305,000 to $335,000 (Exh. NEC/MEC-1, at 10). Therefore, the Department finds that the issuance of the New MDFA Bonds for the purpose of refinancing existing MDFA debt is reasonably necessary to accomplish a legitimate purpose in meeting Nantucket's service obligations in accordance with G.L. c. 164, § 14.

---

12 This Order addresses whether the issuance of bonds for purposes of constructing utility plant as a general matter is a "reasonably necessary" utility activity under G.L. c. 164, § 14. The propriety of the Second Nantucket Cable project itself is being addressed in a separate proceeding under consideration by the Department. See Nantucket Electric Company, D.T.E. 04-10.

Concerning MECo's proposed issuance of $65,000,000 in Pledged Bonds, the Department has also found that issuances intended for the purpose of providing collateral for other debt instruments are reasonably necessary to accomplish a legitimate purpose in meeting a company's service obligations. Western Massachusetts Electric Company, D.T.E. 99-36, at 7 (1999). Therefore, the Department finds that the issuance of Pledged Bonds by MECo as security for Nantucket's New MDFA Bonds is reasonably necessary to accomplish a legitimate purpose in meeting the Companies' service obligations in accordance with G.L. c. 164, § 14.[13]

2. Net Plant Test

a. Purpose of Net Plant Test

With regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization, thereby supporting the additional amount of financing, pursuant to G.L. c. 164, § 16. D.P.U. 84-96, at 5. The purpose of the net plant test is both to protect ratepayers from excessive rates associated with overcapitalization and to assure the creditors of a utility that the company has sufficient tangible assets to cover its liabilities. Boston Gas Company, D.T.E. 03-40, at 321 (2003); Colonial Gas Company, D.P.U. 1247-A at 7 (1982); Report of the Department of Public Utilities Relative to the Capitalization of Gas and Electric Companies, Senate Document No. 315, at 8-15 (January 1922). Under the net plant test, a company must present evidence

---

[13] Here, we address whether the issuance of bonds as a guarantee of other debt instruments is a "reasonably necessary" utility activity under G.L. c. 164, § 14. The propriety of MECo's proposed guarantee of Nantucket's indebtedness, as evidenced by the Pledged Bonds, is addressed later in this Order.

showing that its net utility plant (utility plant less accumulated depreciation) is equal to or greater than its total capitalization (the sum of debt, preferred stock and common stock outstanding). D.P.U. 84-96, at 5.

b. Nantucket

In its net plant calculations, Nantucket included in plant $3,002,000 in construction work in progress ("CWIP") (Exh. NEC/MEC-1 (Rev.), exh. RGS-5). The Department has previously found that CWIP should be excluded from a company's plant accounts for purposes of the net plant test calculation because the term "fair structural value of the plant," as used in G.L. c. 164, § 16, includes only plant that is used and useful in providing utility service to ratepayers. Boston Edison Company, D.T.E. 03-129, at 16 (2004); Southern Union Company, D.T.E. 03-64, at 9 (2003); D.P.U. 84-96, at 5. Therefore, we will exclude CWIP from the net plant calculation for the purpose of determining Nantucket's compliance with G.L. c. 164, § 16 (see RR-DTE-7) .

Nantucket also excluded from capitalization $15,679,000 in acquisition premiums associated with the 2000 acquisition of Nantucket by National Grid Group (Exhs. NEC/MEC-1 (Rev.), exh. RGS-5; DTE 1-15; RR-DTE-7; Tr. at 63-65). Nantucket's proposed adjustment for acquisition premiums of $15,679,000 is appropriate, because goodwill is not directly associated with a utility's tangible plant assets. Consequently, goodwill should be excluded as a component in a utility's plant for purposes of determining compliance with G.L. c. 164, § 16. D.T.E. 03-89, at 21; Southern Union Company, D.T.E. 02-27, at 12;

Southern Union Company, D.T.E. 01-32, at 11 (2001); New England Power Company, D.T.E. 00-53, at 8-9 (2000).

Nantucket included in capitalization $2,535,000 in retained earnings, reasoning that retained earnings are a component of common equity (Exhs. NEC/MEC-1 (Rev.), exh. RGS-5; DTE 1-16). While retained earnings are a component of common equity for financial reporting and ratemaking purposes, the unique purposes of the net plant test found in G.L. c. 164, § 16 warrant a different treatment in financing proceedings. See D.T.E. 03-40, at 320.

In order to issues securities pursuant to G.L. c. 164, § 14, a company must demonstrate that its net utility plant (utility plant less accumulated depreciation) is equal to or in excess of its total capitalization. D.T.E. 03-89, at 15-16; D.P.U. 84-96, at 5. Total capitalization is defined as the sum of debt, preferred stock, and common stock outstanding (with the premium on common stock treated as common stock). D.T.E. 03-89, at 23; Southern Union Company, D.T.E. 04-36, at 9-10 (2004); D.P.U. 84-96, at 5. Retained earnings do not constitute "outstanding stock" as the term is used in G.L. c. 164, § 16 and, therefore, are not considered for purposes of the net plant test.

Nantucket included in its capitalization a negative balance totaling $1,158,000 in accumulated other comprehensive income losses (Exh. NEC/MEC-1 (Rev.), exh. RGS-5). These other comprehensive income losses include losses on the sale of securities held for investment purposes and minimum pension liability adjustments (Exh. NEC/MEC-1, exh. RGS-4(A)-1, at 19). This balance sheet item does not represent "outstanding stock" as used in

G.L. c. 164, § 16 and, therefore, will be excluded from consideration in Nantucket's capitalization for the purposes of the net plant test. Southern Union Company, D.T.E. 04-41, at 13 (2004).

In its net plant calculations, Nantucket excluded from its capitalization $1,535,000 in long-term debt scheduled to become due within one year (Exh. NEC/MEC-1 (Rev.), exh. RGS-5). While generally-accepted accounting principles ("GAAP") may define portions of long-term debt payable within one year as short-term debt for public reporting purposes, it is well settled that financial accounting standards do not automatically dictate ratemaking treatment. Boston Edison Company, D.P.U./D.T.E. 97-95, at 76-77 (2001); NYNEX Price Cap, D.P.U. 94-50, at 305 (1996); Massachusetts Electric Company, D.P.U. 92-78, at 79-80 (1992). The impending maturity date of a long-term debt instrument does not transform the debt into a short-term obligation. Commonwealth Electric Company, D.T.E. 02-51, at 6 (2002); Nantucket Electric Company, D.P.U. 91-106/138, at 96 (1991).

Based on the above adjustments, Nantucket's net capitalizable plant as of June 30, 2004 for calculating the net plant test was $31,709,000, while its total capitalization was $28,394,001 ($21,592,000 in long-term debt, plus $1 in common stock, plus $6,801,000 in paid-in capital), resulting in an excess of net utility plant over total capitalization of $3,314,999 (Exh. DTE 1-15; RR-DTE-7). To the extent that the proceeds from the issuance of New MDFA Bonds are used to retire Nantucket's existing long-term debt, there would be no impairment of Nantucket's stock. However, approval of the Companies' request would increase Nantucket's long-term debt by $47,500,000.[14] Consequently, Nantucket's total capitalization would exceed its net utility plant by $45,585,001. We find that Nantucket's current plant investment is, therefore, insufficient to support the proposed issuance.

General Laws c. 164, § 16 grants the Department considerable discretion in prescribing such conditions as may be deemed best adapted to make good within a reasonable time any impairment of capital stock. See e.g., Boston Edison Company, D.T.E. 00-62, at 10-11 (2000); East Northfield Water Company, D.P.U./D.T.E. 97-36, at 6-7 (1997); Colonial Gas Company, D.P.U. 95-76, at 7-8 (1995); Fitchburg Gas and Electric Light Company, D.P.U. 87-195, at 6-8 (1987). The Companies have represented that their plan to complete the Second Nantucket Cable by the end of 2005 will remedy any impairment of Nantucket's capital stock (Exh. NEC/MEC-1 (Rev.) at 20). The Companies propose that if any proceeds from the issuance of the New MDFA Bonds are received prior to the actual need to use them, these funds would be placed in the National Grid USA Money Pool ("Money Pool")[15] and loaned to National Grid USA affiliates on a short-term basis at commercial paper rates (Tr. at 21-24).

---

14 This calculation represents the proposed $65,000,000 financing, less $2,800,000 in 8.5 Percent Series Bonds, along with $14,700,000 in 1996 Series Bonds that will be callable starting July 1, 2006 (Exh. NEC/MEC-1, at 9). For purposes of this calculation, the Department has included in Nantucket's capitalization $1,400,000 in sinking fund payments associated with the 1996 Series Bonds that are scheduled to occur on July 1, 2005.

15 The National Grid USA Money Pool facilitates the short-term borrowing needs of all National Grid USA operating companies, including MECo and Nantucket, through the pooling of funds by participants in order to obtain a lower cost of borrowing (Tr. at 21-22). See Massachusetts Electric Company/Nantucket Electric Company/New England Hydro-Transmission Electric Company/New England Power Company, D.T.E. 01-104, at 2 (2002).

Having found the proposed financing is reasonably necessary to meet Nantucket's service obligations in accordance with G.L. c. 164, § 14, the Department will approve the Companies' request with the following conditions: (1) the Second Nantucket Cable is placed into service by December 31, 2005; (2) any proceeds that are not immediately needed for construction are placed in the Money Pool; and (3) any borrowings from the Money Pool by other pool participants do not impede the ability of Nantucket to access the Money Pool to finance its own construction program. The Department finds that the above conditions will allow Nantucket to cure any impairment of its capital stock within a reasonable period of time.

Our approval here is predicated on the Companies' representations that all regulatory approvals and permits can be obtained by the end of 2004 (Exh. NEC/MEC-1 (Rev.) at 8; Tr. at 46-50; RR-DTE-6). Nantucket anticipates an in-service date for the Second Nantucket Cable project of late 2005, during the last quarter of the year (Exh. NEC/MEC-1 (Rev.) at 20; DTE 1-1, Att. A at 7). If Nantucket is unable to obtain the necessary approvals and permits in a timely manner, the Companies may seek an extension of the December 31, 2005 in-service date required by this Order. The Companies state that, if the Second Nantucket Cable project is cancelled or otherwise terminated, the maximum borrowing required would be $25 million (Revised Application at 4). Therefore, if the Second Nantucket Cable project is cancelled or otherwise terminated, any unused borrowing authority in excess of $25 million will be void and of no effect.

Issues concerning the prudence of the Companies' capital financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Companies or their ratepayers. The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing.

c. MECo

MECo's net capitalizable plant as of March 31, 2004 for calculating the net plant test is $1,560,826,000, while its total capitalization is $802,608,000 ($252,209,000 in long-term debt, plus $4,727,000 in premium stock, plus $59,953,000 in common stock, and $485,719,000 in paid-in capital) (Exh. NEC/MEC-1, exh. RGS-4(B) at 3). This results in an excess of net utility plant over outstanding capital of $758,218,000 (id.). The Department finds that MECo's current plant investment is sufficient to support the proposed issuance of $65 million in Pledged Bonds.

3. Maximum Interest Rates

For both the fixed and variable rate modes associated with tax-exempt securities to be issued through the MDFA, Nantucket proposes a maximum effective interest rate equal to the then-current rate for U.S. Treasury securities of similar maturity, plus 150 basis points (Exh. NEC/MEC-1 (Rev.) at 12). For those New MDFA Bonds that would be issued as, or become, taxable securities, as well as any borrowings in the form of National Grid Notes, Nantucket proposes that the maximum interest rate will not exceed the then-current rate for U.S. Treasury securities of similar maturity plus 300 basis points (id.). Nantucket contends that these interest rate limits will provide it with flexibility to refinance the proposed debt during its term in the event that market conditions should change (id.).

The Department recognizes that the potential for financial market volatility requires the allowance of a measure of flexibility in setting maximum interest rates for long-term debt securities. D.T.E. 03-129, at 16-17; D.T.E. 03-89, at 26; D.T.E. 01-32, at 12. In addition, in the case of variable rate debt, the Department has recognized that the maximum rate must be sufficient to allow the interest rate to vary over the life of the debt instrument without undue risk to either the investor or the issuer. D.T.E. 04-51, at 13; Boston Edison Company, D.P.U. 89-44, at 4-5 (1989).

Nantucket's proposed maximum rates are based on Lehman Brothers' analyses of debt instrument trading spreads (Exhs. DTE 1-6; DTE 1-7; Tr. at 9). Since 1994, the trading spread between tax-exempt 30-year municipal high-grade bonds and corresponding U.S. Treasury securities has ranged between a negative 1.7 basis points[16] and 73.3 basis points, for an overall trading spread of 75 basis points (Exh. DTE 1-6; Tr. at 94-95). Nantucket has requested another 75 basis points to account for future uncertainties, particularly for those New MDFA Bonds that may carry longer maturities (Exh. DTE 1-6; Tr. at 95-96).

A spread between a utility's interest rate on debt and the proposed maximum interest rate is necessary to provide some cushion against interest rate increases over the term of the instruments (Exh. NEC/MEC-1 (Rev.) at 12; Tr. at 90). The Department has recognized that

---

16 On November 1, 2001, the 30-year U.S. Treasury bond yield was 1.7 basis points greater than the yield for 30-year high-grade municipal bonds (Tr. at 94-95).

variable-rate debt instruments carrying longer maturities may require a greater maximum interest rate than shorter-term debt instruments. D.T.E. 03-129, at 18. Nantucket has demonstrated that the 150 basis points cap for tax-exempt debt provides an adequate cushion to allow for market fluctuations over the proposed period, without being in excess of anticipated market requirements (Exh. DTE 1-6; Tr. at 95-96).

In the case of taxable issues, the greatest trading spread between taxable A-rated utility bonds and corresponding U.S. Treasury securities since 1994 has been 222 basis points for ten-year instruments and 240 basis points for 30-year instruments (Exh. DTE 1-7). Nantucket estimated that an additional 60 to 75 basis points would provide for future uncertainties (Exh. DTE 1-7; Tr. at 96-97).

As with tax-exempt securities, a spread between the Company's interest rate on taxable debt and the proposed maximum interest rate is necessary to provide some cushion against interest rate increases over the term of the instruments (Exh. NEC/MEC-1 (Rev.) at 10). Nantucket has demonstrated that its proposed 300 basis points cap for taxable issues provides an adequate cushion to allow for market fluctuations over the proposed period, without being in excess of anticipated market requirements (Exh. DTE 1-7; Tr. at 96-97).

In view of historic Treasury and utility bond yields, current market conditions and long-term economic expectations, the Department finds that the Company has appropriately evaluated the market for both fixed and variable interest rate securities in determining the proposed maximum interest rate for these instruments. D.T.E. 04-51, at 14; D.T.E. 03-129, at 17; D.T.E. 03-64, at 11-12. Therefore, the Department finds a maximum interest rate cap of 150 basis points over corresponding U.S. Treasury securities for tax-exempt securities and a maximum interest rate cap of 300 basis points over corresponding U.S. Treasury securities for non tax-exempt securities, for the issuance of variable term and fixed rate debt securities, is appropriate.

B. Exemption From G.L. c. 164, § 15

Nantucket and MECo contend that an exemption from the competitive bidding provisions of G.L. c. 164, § 15 is appropriate because a competitive bid may limit the Companies' ability to price and market securities through the MDFA, as well as to determine the form and timing of an issuance (Exh. NEC/MEC-1 (Rev.) at 21). The Department recognizes the role of the MDFA in assuring that utility companies relying on tax-exempt debt issuances will generate substantial savings in interest expense and, thereby, provide the benefits of compensation and timely issuance of securities to the Company's ratepayers. D.T.E. 04-51, at 14; Nantucket Electric Company, D.P.U. 90-334, at 5 (1991). Moreover, Nantucket intends to seek the conversion of its taxable debt to tax-exempt debt as the opportunity may arise in the future (Exh. DTE 1-2, Tr. at 80-82).

The Companies have demonstrated that underwriting assistance in the form of evaluating market conditions and structuring tax-exempt debt is an important element in the conversion of taxable debt to tax-exempt debt (Exh. DTE 1-3). Confining Nantucket's debt placement to a competitive bid process may reduce its ability to execute the loan agreement with the MDFA in a manner that takes full advantage of market conditions.

The Department finds that the Companies have shown that a competitive bid process could deter investor interest, ultimately jeopardizing the financial benefits available to ratepayers under the negotiated public offering process. D.T.E. 01-43, at 8; New England Power Company, D.T.E. 00-53, at 10 (2000). The Department further finds that the Companies have demonstrated that the benefits of a competitive solicitation process are enjoyed by their ratepayers through the negotiated public offering process and that the additional cost and time associated with a competitive solicitation process would not produce a more favorable result to ratepayers. D.T.E. 02-49, at 12. In this case, it is appropriate to allow the Companies the flexibility offered by the negotiated public offering process in order to facilitate the Companies' access to the capital markets. D.T.E. 00-62, at 11. Therefore, based on the foregoing analysis, the Department finds that it is in the public interest to exempt the Companies from the advertising requirements of G.L. c. 164, § 15.

C. Exemption From G.L. c. 164, § 15A

Regarding the Companies' request for an exemption from the par value requirements of G.L. c. 164, § 15A, the Department recognizes that investors rely on, and expect, such discounts to serve as a fine-tuning device to ensure that the coupon rate matches market expectations, thereby offering the utilities increased flexibility in placing their issuances with prospective investors. D.T.E. 03-89, at 16-17; Southern Union Company, D.T.E. 01-32, at 8, 12 (2001); D.P.U. 92-127, at 8; Boston Edison Company, D.P.U. 91-47, at 12-13 (1991); Bay State Gas Company, D.P.U. 91-25, at 10 (1991). Moreover, investors may at times accept a lower coupon rate, such as provided by discounts, as part of their overall investment and tax strategy (Exh. DTE 1-4). Consequently, this increased flexibility afforded by discounts enables a company to issue debt securities in a timely manner and take advantage of favorable market conditions. Moreover, because the Pledged Bonds must track the terms and conditions of the New MDFA Bonds which may be sold at a discount, an exemption from the requirements of G.L. c. 164, § 15A is necessary to ensure that the Company may successfully issue the Pledged Bonds. D.T.E. 04-51, at 16.

For these reasons, the Department finds that it is in the public interest to exempt the Companies from the par value requirements of G.L. c. 164, § 15A. Consistent with this exemption, the Department directs the Companies to amortize the amount of any discount from par value over the life of the new issuance series on a straight line basis. Massachusetts Electric Company, D.P.U. 96-109, at 8-9 (1997).

D. Section 17A Guarantee of Nantucket Debt

Under G.L. 164, § 17A, a petitioner must demonstrate that the proposal is consistent with the public interest. Upon consideration of all of the significant aspects of a proposal, the petitioner must show that the public interest is at least as well served by approval of the proposal as by its denial. D.P.U. 91-165. The application of the public-interest standard in a § 17A evaluation is based on the totality of what can be achieved by the proposal rather than a determination of any single gain (or loss) that might be derived from the proposed transactions. See Id.

MECo is already authorized to guarantee Nantucket's outstanding MDFA Bonds. D.P.U. 95-67, at 15-16. While MECo currently has a favorable credit rating from the credit rating agencies, Nantucket does not have a credit rating (Exh. NEC/MEC-1 (Rev.) at 14; Tr. at 29). In order to obtain a credit rating from one of the rating agencies, Nantucket would be obligated to incur significant expenses relative to rating agency fees on both an up-front and ongoing basis (Tr. at 29, 32-33, 114-115). MECo's guarantee would allow Nantucket to adopt MECo's favorable credit rating, thereby increasing the likelihood that Nantucket can obtain favorable interest rates for the New MDFA Bonds (Exh. NEC/MEC-1 (Rev.) at 32). Also, because Nantucket does not have any first mortgage debt, the lack of indenture provisions found with first mortgage bonds would make it difficult for Nantucket to issue Pledged Bonds under its own name on an economic basis (Tr. at 33-34). Because MECo has existing first mortgage debt, a guarantee by MECo of Nantucket's debt would give investors a security interest in MECo's property, thus facilitating the marketing of the New MDFA Bonds to potential purchasers while reducing the overall cost to Nantucket (id. at 14-15; Tr. at 33-35; D.T.E. 95-67, at 16).

Nantucket anticipates it will request authority from the Department to recover the cost associated with the Second Nantucket Cable from Nantucket's customers through a separate surcharge calculated in a manner similar to the existing cable facilities surcharge mechanism, as provided in its Cable Facilities Surcharge Provision, M.D.T.E. No. 392 (Exh. NEC/MEC-1 (Rev.) at 8; Tr. at 31). MECo argues that a financial guarantee on behalf of Nantucket does not impose any significant risk because, with the exception of the Cable Facilities Surcharge, MECo and Nantucket are combined for ratemaking purposes (Exh. DTE 1-23). In addition, as part of the 1995 acquisition of Nantucket by New

England Electric System, MECo's predecessor holding company, a credit and operating support agreement between MECo and Nantucket was approved by the Department. D.P.U. 95-67, at 15-16. The credit and operating support agreement provides that if Nantucket earns less than its allowed rate of return on common equity ("ROE") in a given fiscal year, MECo will make a contribution to Nantucket sufficient to ensure that Nantucket will earn the same ROE as allowed by the Department for MECo during that same fiscal year (Exh. DTE 1-24; Tr. at 38-39; RR-DTE-4). The capital contributions that may be made from time to time by MECo to Nantucket under the credit and operating support agreement reduce the overall risk of default by Nantucket, by allowing Nantucket to maintain its financial integrity if its revenues are inadequate to meet its overall cost of service. D.P.U. 95-67, at 16.[17]

Even in the unlikely event that Nantucket were to default on its New MDFA Debt, Nantucket is relatively small in size when compared to MECo (equal to 1.9 percent of MECo's total assets as of March 31, 2004 and one percent of MECo's operating revenues for fiscal year 2004) (Exh. DTE 1-23). The Department has examined MECo's financial data and is satisfied that the financial viability of MECo will not be negatively affected if it were obligated to act upon its guarantee of Nantucket's debt (Exh. DTE 1-22). Because of Nantucket's relatively small size in relation to MECo and because of MECo's financial position, the Department is

---

17 During the fiscal year ending March 31, 2004, MECo reimbursed Nantucket for $1.8 million through the credit and operating support agreement (Exh. NEC/MEC-1, exh. RGS-4(A)-1, at 6).

satisfied that a default on Nantucket's New MDFA Debt would pose minimal risk to MECo's ratepayers.

Based on the foregoing analysis and considering all of the factors involved in MECo's proposed guarantee of the Nantucket financing, the Department is persuaded that the guarantee will cause no net harm to ratepayers and that the public interest is at least as well served by approval of the Companies' proposal as by its denial. Therefore, the Department finds that the Companies' proposal is consistent with the public interest and is approved.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department

VOTES: That the execution, from time to time on or before December 31, 2007, by Nantucket Electric Company of one or more loan agreements, supplemental loan agreements, or notes, with the Massachusetts Development Finance Agency, or with direct or indirect parents of Nantucket Electric Company, in an amount not exceeding $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, in connection with the issuance of new taxable or tax-exempt debt to finance the Second Nantucket Cable Project, refinance outstanding taxable or tax-exempt bonds, or finance capital expenditures, together with related credit, liquidity support, financing, and security agreements (including, but not limited to, letter or line of credit, standby bond purchase agreements, reimbursement agreements, and bond insurance), is reasonably necessary for the purposes for which such issuance has been authorized; and

VOTES: That the execution by Nantucket Electric Company, from time to time on or before December 31, 2007, as volume cap becomes available, of loan agreements or supplemental loan agreements with the Massachusetts Development Finance Agency to refinance as tax-exempt debt maturing in not more than 40 years, some or all of any portion of the debt referred to herein initially issued as taxable debt through the Massachusetts Development Finance Agency, or incurred through borrowings from Nantucket Electric Company's direct or indirect parents, together with related credit, liquidity support, financing, and security agreements (including, but not limited to, letter or line of credit, standby bond purchase agreements, reimbursement agreements, and bond insurance), is reasonably necessary for the purposes for which such issuance has been authorized; and

VOTES: That the issuance, from time to time on or before December 31, 2007, by Massachusetts Electric Company of one or more series of first mortgage bonds in an amount not exceeding $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, each such issue of said bonds to bear the same rate of interest as the corresponding issue of Massachusetts Development Finance Agency bond issue or issues on behalf of Nantucket Electric Company referred to herein, to be pledged as security for such Massachusetts Development Finance Agency bond issue or issues referred to herein, together with related credit, liquidity support, financing, and security agreements (including, but not limited to, letter or line of credit, standby bond purchase agreements, reimbursement agreements, and bond insurance), is reasonably necessary for the purposes for which such issuance has been authorized; and

VOTES: That the guaranty by Massachusetts Electric Company of an amount not exceeding $65 million in the aggregate outstanding at any one time of the Massachusetts Development Finance Agency bond issue or issues on behalf of Nantucket Electric Company referred to herein is in the public interest; and

VOTES: That Nantucket Electric Company's execution of one or more loan agreements, supplemental loan agreements, or notes, from time to time on or before December 31, 2007, with the Massachusetts Development Finance Agency, or with direct and indirect parents of Nantucket Electric Company, in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, the issuance by Massachusetts Electric Company of first mortgage bonds intended as security for the Massachusetts Development Finance Agency bond issue or issues referred to herein in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, as well as the execution by Nantucket Electric Company, from time to time, as volume cap becomes available, of loan agreements or supplemental loan agreements with the Massachusetts Development Finance Agency to refinance as tax-exempt debt maturing in not more than 40 years some or all of any a portion of the debt referred to herein initially issued as taxable debt through the Massachusetts Development Finance Agency, or incurred through borrowings from Nantucket's direct or indirect parents, at less than par value, is in the public interest, and such issuance and sale shall be exempt from the provisions of G.L. c. 164, § 15A; and that if a security is sold at less than par value, it is in the public interest to amortize the discount from par value over the life of the new issuance series on a straight-line basis; and

ORDERED: That the execution by Nantucket Electric Company, from time to time on or before December 31, 2007, of one or more loan agreements, supplemental loan agreements, or notes, with the Massachusetts Development Finance Agency, or with direct or indirect parents of Nantucket Electric Company, in connection with the issuance of new taxable or tax-exempt debt to finance the Second Nantucket Cable Project, refinance outstanding taxable or tax-exempt bonds, or finance other capital expenditures, in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, together with related credit, liquidity support, financing, and security agreements (including, but not limited to, letter or line of credit, standby bond purchase agreements, reimbursement agreements, and bond insurance), and the issuance, from time to time on or before December 31, 2007, of one or more series of first mortgage bonds by Massachusetts Electric Company in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, for the purpose of pledging with a bond insurer or with a trustee as security for such loan agreements or supplemental loan agreements with the Massachusetts Development Finance Agency, is authorized and approved; and it is

FURTHER ORDERED: That the execution by Nantucket Electric Company, from time to time on or before December 31, 2007, as volume cap becomes available, of loan agreements or supplemental loan agreements with the Massachusetts Development Finance Agency to refinance as tax-exempt debt maturing in not more than 40 years some or all of any a portion of the debt referred to herein which is initially issued as taxable debt through the Massachusetts Development Finance Agency, or incurred through borrowings from Nantucket Electric Company's direct or indirect parents, as well as the issuance, from time to time on or before December 31, 2007, of one or more series of first mortgage bonds by Massachusetts Electric Company in an amount not exceed $65 million in the aggregate outstanding at any one time, and with maturities not exceeding 40 years, for the purpose of pledging with a bond insurer or a trustee as security for such refinanced debt, is authorized and approved; and it is

FURTHER ORDERED: That such authorized long-term debt securities, if initially issued as taxable securities, shall carry a fixed or variable interest rate not to exceed 300 basis points above the then-current rate for U.S. Treasury securities of similar maturity, and that such authorized long-term debt securities, if issued as tax-exempt securities, shall carry a fixed or variable interest rate not to exceed 150 basis points above the then-current rate for U.S. Treasury securities of similar maturity or, in the event that the said securities become taxable securities, the interest rate will not exceed 300 basis points above the then-current rate for U.S. Treasury securities of similar maturity; and it is

FURTHER ORDERED: That the net proceeds from such sale of all such securities shall be used for the purposes as set forth herein; and it is

FURTHER ORDERED: That Nantucket Electric Company's execution of one or more loan agreements, supplemental loan agreements, or notes, from time to time on or before December 31, 2007, with the Massachusetts Development Finance Agency, or with direct or indirect parents of Nantucket Electric Company, in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, as well as the issuance, from time to time on or before December 31, 2007, by Massachusetts Electric Company of first mortgage bonds intended as security for the aforementioned Massachusetts Development Finance Agency bond issue or issues in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, without complying with the competitive bidding and publication provisions of G.L. c. 164, § 15 is in the public interest, and that such issuance and sale shall be exempt from the provisions of G.L. c. 164, § 15; and it is

FURTHER ORDERED: That Nantucket Electric Company's execution of one or more loan agreements, supplemental loan agreements, or notes, from time to time on or before December 31, 2007, with the Massachusetts Development Finance Agency, or with direct or indirect parents of Nantucket Electric Company, in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, as well as the issuance, from time to time on or before December 31, 2007, by Massachusetts Electric Company of first mortgage bonds intended as security for the aforementioned Massachusetts Development Finance Agency bond issue or issues in an amount not to exceed $65 million in the aggregate outstanding at any one time, and with maturities not to exceed 40 years, at less than par value, is in the public interest, and such issuance and sale shall be exempt from the provisions of G.L. c. 164, § 15A; and that if a security is sold at less than par value, Massachusetts Electric Company and Nantucket Electrtic Company shall amortize the discount from par value over the life of the new issuance series on a straight-line basis; and it is

FURTHER ORDERED: That the guaranty by Massachusetts Electric Company in an amount not exceeding $65 million in the aggregate outstanding at any one time of Massachusetts Development Finance Agency bond issue or issues on behalf of Nantucket Electric Company as referred to herein, is authorized and approved; and it is

FURTHER ORDERED: That Nantucket Electric Company and Massachusetts Electric Company shall comply with all other directives contained in this Order; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

/s/
____
Paul G. Afonso, Chairman

/s/
____
James Connelly, Commissioner

/s/
____
W. Robert Keating, Commissioner

/s/
____
Eugene J. Sullivan, Jr., Commissioner

/s/
____
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within 20 days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of 20 days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971.